

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Bates Analyst: Darrine Distefano Bill Number: AB 665
Related Bills: See Legislative History Telephone: 845-6458 Introduced Date: 02/22/2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Child Adoption Credit/FTB Report To Legislature Annually

SUMMARY

This bill would allow a credit for adoption expenses not covered by the current State Child Adoption Credit.

PURPOSE OF THE BILL

According to the author's staff the purpose of this bill is to create a modified version of the federal adoption credit, to compensate costs above the federal adoption expense amount, and to compensate costs of adoptions not handled through a public agency.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. It would apply to taxable years beginning on or after January 1, 2001, and before January 1, 2007.

POSITION

Pending.

Summary of Suggested Amendments

Amendment 1 has been provided to correct a technical reference.

ANALYSIS

FEDERAL/STATE LAW

Federal law allows taxpayers to claim a nonrefundable credit for expenses incurred in adopting a child up to a maximum of \$5,000 per adoption (\$6,000 for a special needs adoption). In addition, taxpayers may exclude from gross income employer contributions toward adoption expenses up to a maximum of \$5,000 per adoption (\$6,000 for a special needs adoption). The credit and exclusion are phased out for taxpayers with adjusted gross income (AGI) over \$115,000. The \$5,000 credit and the exclusions will not be available for expenses incurred after December 31, 2001. However, the \$6,000 special needs adoption credit is permanent. Any credit unused in the year earned may be carried forward for five years.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

05/10/01

Current state law allows a credit equal to 50% (not to exceed \$2,500) of the taxpayer's costs to adopt a minor child who is a citizen or legal resident of the United States and was in the custody of a public agency or political subdivision of California. The costs eligible for the Child Adoption Credit include fees for required services of the Department of Social Services or a licensed adoption agency, costs for travel, and expenses for the adoptive family that are directly related to the adoption process. In addition, medical fees that are not reimbursed by insurance and are directly related to the adoption are qualified expenses.

THIS BILL

This bill would allow a state credit equal to 50% of the taxpayer's costs above \$5,000 (\$6,000 for a child with special needs). The credit cannot exceed \$10,000 (\$11,000 for a child with special needs). The credit would be allowed for an adoption that is not eligible for the current State credit for public agency adoptions. The provisions in this bill would conform to the federal adoption credit with certain modifications.

This bill would modify the federal definition of "eligible child" to mean any individual who meets at least one of the following requirements: is not yet 18 years of age, is physically or mentally incapable of caring for himself or herself, or is a child with special needs.

This bill would require the Franchise Tax Board (FTB) to report in 2003, and each following year, the total amount of tax credits claimed and allowed for the credit created by this bill and under the current Child Adoption Credit. To the extent the information is available, the report should include how each of the credits allowed was distributed across AGI classes. .

IMPLEMENTATION CONSIDERATIONS

Recent credits have been enacted with a limit on the carryover period since experience has shown credits are typically exhausted within eight years. The carryover period for this credit is not limited, which would require the department to keep the credit on the tax returns indefinitely.

The language could be interpreted to allow expenses that exceed the limit under the existing Child Adoption Credit to qualify. However it is the author's intent to cover only private and foreign adoptions. The language needs clarification to ensure that the intent is met.

The bill has intent language specifying that the credit should be available as long as the federal credit is allowed. This language is inconsistent with the January 1, 2007 sunset date provided in the bill in two ways. First, the federal credit as it applies to regular adoptions ends in 2001, but the State credit proposed by this bill would continue until it sunsets January 1, 2007. Second, the federal credit for special needs adoptions continues indefinitely but the State credit proposed by this bill would end when it sunsets January 1, 2007.

The bill requires the department to report annually on the prior year's credit use. Since the due date for personal income tax returns is April 15, with an automatic extension to October 15, the department would not have complete information for the preceding taxable year and could provide only a preliminary report in the succeeding year. If the author's intent is to have each report contain complete information for the taxable year, the author may consider changing the reporting requirement so that the department provides an annual report of the most current information available.

TECHNICAL CONSIDERATIONS

Amendments have been provided to correct punctuation and an inaccurate Internal Revenue Code reference.

LEGISLATIVE HISTORY

SB 1920 (Lewis, Stats. 1994, Ch. 827) enacted the current Child Adoption Credit.

AB 119 (Runner, 1997/1998), died in Senate Appropriations. This bill would have repealed the existing State adoption credit and allowed a State credit equal to 50% of the costs above \$5,000 (\$6,000 in the case of a special needs adoption) but below \$10,000 for an adoption that qualifies for the federal credit.

AB 763 (Bates, 1999/2000), died in the Assembly Appropriations. This bill would have conformed to the federal child adoption credit with a 50% credit for adoption costs that were not eligible for the current State Child Adoption Credit.

AB 246 (Campbell, 2000/2001) currently in the Assembly, would increase the Child Adoption Credit from 50% to 100% of the taxpayer's costs for adopting a minor child.

OTHER STATES' INFORMATION

Massachusetts provides a limited exemption to taxpayers for adoption fees paid to a licensed adoption agency.

Review of *Illinois*, *Michigan*, *Minnesota*, and *New York* laws found no comparable tax credits or deductions.

These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

This bill would result in revenue losses as shown in the following table:

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2000 Enactment Assumed After June 30, 2001 \$ Millions		
2001-02	2002-03	2003-04
-\$3	-\$5	-\$6

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

The revenue impact for this bill will be determined by the number of qualified adoptions made during any given taxable year, average qualifying costs, and the tax liabilities of claimants.

This estimate was developed in the following steps. First, the total number of adoptions by California residents was based on information received from the Department of Social Services. During fiscal year 1998-9, there were approximately 8,270 adoptions in California, of which 5,210 were public agency, 760 private, 1,300 independent, and 1,000 intercountry. Second, the total number of adoptions was increased 5% per year to allow for growth and an incentive effect from both federal and state tax incentives. Third, it was assumed that independent, private, and intercountry adoptions would qualify for this credit.

The typical cost for these adoptions is \$15,000 to \$18,000 per child. The maximum credit under this bill would be \$2,500 per child adopted. It was assumed that the average credit for taxpayers with AGIs less than \$75,000 would be \$2,500 and for taxpayers with AGIs between \$75,000 and \$115,000 would be \$1,250 due to the AGI phase out.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 665
As Introduced February 22, 2001

AMENDMENT 1

On page 2, line 14, after "\$5,000)", strikeout ", "

AMENDMENT 2

On page 2, line 15, after "needs)", insert:

AMENDMENT 3

On page 2, line 16, after "\$10,000)", strikeout ", "

AMENDMENT 4

On page 2, line 18, strike "23(d)" and insert:

23(c)